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SUBJECT: MEXICAN CONGRESS MEMBERS DISCUSS ENERGY REFORM

Sensitive but unclassified, entire text.

Summary

¶1. (SBU) The Mexican Autonomous Technological Institute (ITAM) January 22 hosted an energy conference on January 22. The event drew over 100 people, including representatives from all three political parties in Congress, the Mexican Council on International Affairs (Comexi), academia and policy institutes, as well as the private sector. Topics discussed included an overview of the Western Hemisphere energy situation, the relationship between energy and public finances in Mexico, and finally a discussion of prospects for reform among Members of the Mexican Congress End Summary.

Western Hemisphere Energy

¶2. (SBU) The lead-off panel presented the Center for Strategic and International Studies (CSIS) book Energy Cooperation in the Western Hemisphere, edited by Dr. Sidney Weintraub. The book has chapters on the U.S., Canada, Mexico, Venezuela, Argentina, Peru, Brazil and Ecuador, Colombia, Bolivia and Trinidad and Tobago. It focuses on political, rather than technical obstacles to cooperation, within and among countries of North and South America.

¶3. (SBU) In that discussion, Milton Costa, author of the Brazil chapter (and President of Petrobras Mexico) was asked what makes Petrobras different from Pemex. He replied that because Brazil has little oil itself, Petrobras has always been searching for more oil, rather than "administering oil wealth" as Pemex has done since the discovery of Cantarell. He argued that this resource limitation made it easier to reach political consensus on investing in technology and exploration that has made Petrobras a world leader. However, he also said the process was very difficult and that key reforms were passed during a "window of opportunity" of legislative negotiations.

Oil and Public Finance

¶4. (SBU) In a Panel discussion on Oil and Public Finance,

moderator, Journalist Macario Schettino opened with a chronology of Mexico's failed efforts to expand its tax base. Mexican tax collection amounts to less than 11 percent of GDP, compared with close to 40 percent in Brazil; the discovery of Cantarell allowed successive Mexican governments to avoid fiscal reality and reform; and recent production declines should force government to finally take decisive action.

¶ 15. (SBU) Independent consultant Jorge Chavez Presa built on Schettino's basic argument by providing extensive public finance data. He maintained that oil has allowed Mexico to artificially declare a surplus when the federal government operating budget - taking into account only tax income - is actually in a huge deficit. Because the parastatal sector makes so much money, the finance ministry can simply manufacture a fiscal balance. National Action Party (PAN) Senator Gustavo Madero followed Chavez Presa by stating that Mexico's lack of tax policy has increased its dependence on oil, and that this has exposed the country to a fiscal crisis when production falls off.

¶ 16. (SBU) Commentator Isaac Katz, an ITAM economics professor, reiterated the political point that oil resources had undermined any political incentive for reforming the fiscal regime, and that the huge oil bonanza has made states and municipalities increasingly dependent on federal revenue transfers. He argued that in the future, in the absence of fundamental reforms, Mexico must expect falling revenues (because of oil production decline) and increased expenditures (Pediregas or off-balance-sheet financing, pension liabilities, etc). Katz concluded that Mexico must pursue two measures: fiscal reform and private investment in Pemex.

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#### Legislators Views

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¶ 17. (SBU) A Panel on Legislative Perspectives included three Senators from the Senate Energy Committee: Francisco Labastida, Institutional Revolutionary Party (PRI) who is President of the Committee, Jorge Ocejo (PAN) and Arturo Nunez, Democratic Revolutionary Party (PRD). The panel also included Manuel Alonso Lizaola another PAN deputy.

¶ 18. (SBU) Ocejo's presentation reviewed regulatory challenges to reforming Pemex, and usefully included specific laws that should be amended. His basic proposal was "flexibility and autonomy" for Pemex. He also insisted on the political principle of pursuing small but cumulative gains, and to "avoid all-or-nothing proposals." Ocejo suggested that Congress should proceed step by step in areas where there is the potential for consensus, such as institutional autonomy, rather than trying to open up the oil sector all at once.

¶ 19. (SBU) Labastida reiterated the basic narrative that preceded and stated that the urgency of the problem required a speedy legislative response. Moderator David Shields prodded the PRI Senator by suggesting that the Pemex union was controlled by the PRI, and asked whether the union shared his sense of urgency for reform. Labastida responded that while the union included many PRI members, it was not PRI's property, and that union support for reform would depend on the nature of the reform.

¶ 10. (SBU) Nunez argued that Mexico's energy policy had long been subordinated to fiscal policy, and called for a "second oil expropriation," only this time from Hacienda. He also reiterated the earlier point that Mexico's energy problem cannot be resolved without fundamental tax reform. He specifically proposed legislative action to strengthen the Ministry of Energy vis-a-vis Ministry of Finance (Hacienda). He concluded that there was considerable agreement among the parties on the diagnosis of the problem, and that what

remained was to agree on how to solve it.

¶11. (SBU) In the question period, one audience member complained that there was too much diagnosis and not enough real debate within Congress about substantive options. Labastida responded that the best way to proceed is through debate among Congress members, but not out in the open. He argued that only when some degree of agreement is reached through internal discussion should a proposal be put on the table in public.

¶12. (SBU) Former Senator Silvia Hernandez (PRI), discussed the need to build "alliances" around energy reform. She also urged the conference organizers to promote awareness-building on sustainability and fiscal issues related to the oil sector, in order to influence public opinion about reform.

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